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Chief, Technical Branch 4  
Exempt Organizations Division CP:E:EO:T:4

[Acting] Chief, Branch 4 (Disclosure Litigation) CC:EL:D

Disclosure of Conduit Borrower Tax Information During Tax- Exempt Bond  
Examination

You requested our advice on the following disclosure issue. Taxpayers do not have to include in income interest on qualified small issue bonds, as defined in I.R.C. § 144(a). I.R.C. §§ 103(b)(1), 141(e)(1)(D). Generally, the proceeds of these qualified private activity bonds are lent to for-profit taxpayers (conduit borrower) to construct manufacturing facilities. The face amount of such bonds must be \$1,000,000 or less. I.R.C. § 144(a)(1). However, generally, if prior issues of qualified small issue bonds were used with respect to facilities in the same governmental unit and the principal user of the facilities is the conduit borrower or a related taxpayer, those prior issues are taken into account in determining the \$1,000,000 limitation. I.R.C. § 144(a)(2). In addition, under certain circumstances, the issuer may elect a \$10,000,000 limitation. In computing the \$10,000,000 limitation, prior qualified small issue bonds are taken into account in accordance with section 144(a)(2) described above. Further, included in the \$10,000,000 limitation are capital expenditures of the conduit borrower or related taxpayers for facilities in the same governmental unit for a window period of three years before and three years after the financing. I.R.C. § 144(a)(4).

You have indicated that the conduit borrower's depreciation schedule on its Form 1120 will reflect the amount of capital expenditures with respect to its facilities. You have asked whether the conduit borrower's depreciation schedule may be used by the revenue agent in the examination of the bonds and disclosed to the issuer.

The depreciation schedule of the conduit borrower is part of the return of a third party. It can only be disclosed to the issuer as authorized by section 6103.<sup>1</sup>

Section 6103(h)(4) provides:

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<sup>1</sup> Note that section 6103(k)(6) (disclosures to obtain information not otherwise reasonably available) does not permit the disclosure of returns, but only return information. In any event, it seems to us implausible that a case could be made for a section 6103(k)(6) disclosure to the issuer on these facts.

A return or return information may be disclosed in a Federal ... judicial or administrative proceeding pertaining to tax administration, but only--

(A) [if] the taxpayer is a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer's civil or criminal liability, or the collection of such civil liability, in respect of any tax imposed under this title;

(B) if the treatment of an item reflected on such return is directly related to the resolution of an issue in the proceeding; [or]

(C) if such return or return information directly relates to a transactional relationship between a person who is a party to the proceeding and the taxpayer which directly affects the resolution of an issue in the proceeding ... .

An examination, with its numerous procedural steps and protections and its appeal process, constitutes an "administrative proceeding" pertaining to tax administration. First Western Government Securities v. United States, 578 F. Supp. 212, 217 (D. Colo. 1984), aff'd, 796 F.2d 356 (10th Cir. 1986); Ungaro v. Desert Palace, Inc., 91-1 U.S.T.C. ¶ 50,294 (D. Nev. 1986); DataMatic Services Corp. v. United States, 88-1 U.S.T.C. ¶ 9163 (N.D. Cal. 1987). See Proc. & Admin. Reg. §§ 601.105--601.106. Contra Mallas v. United States, 993 F.2d 1111 (4th Cir. 1993). Subparagraphs (B) and (C) of section 6103(h)(4) permit the disclosure of third-party tax information, and are referred to as the "item" and "transaction" tests, respectively. See S. Rep. No. 938, 94th Cong., 2d Sess. 325-326 (1976), 1976-3 C.B. (Vol. 3) 363-364; First Western Government Securities, Inc. v. United States, 578 F. Supp. 212 (D. Colo. 1984), aff'd, 796 F.2d 356 (10th Cir. 1986); Davidson v. Brady, 559 F. Supp. 456 (W.D. Mich. 1983), aff'd, 732 F.2d 552 (6th Cir. 1984). As such, the conduit borrower's returns, or information from the returns, can be disclosed during the issuer's examination if the "item" or "transaction" tests are met.

To the extent the conduit borrower's depreciation schedules reflect the capital expenditures described in I.R.C. § 144(a)(4) that are taken into account in determining the \$10,000,000 limitation, such information could be disclosed as part of the issuer's examination pursuant to I.R.C. § 6103(h)(4)(B) and/or (C). Based on the legislative history of section 6103(h)(4), only the portion or portions of the depreciation schedule that reflect the capital expenditures counted for purposes of section 144 should be disclosed to the issuer, not the entire return.<sup>2</sup>

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<sup>2</sup> If the return is to be used in a subsequent court case, it is possible that more of the return may have to be disclosed for evidentiary purposes.

If you have any further questions or comments, please contact David Fish, the attorney assigned to this matter, at 622-4570.

(signed) David L. Fish

for JOSEPH J. URBAN

cc: Assistant Chief Counsel  
(Financial Institutions & Products)  
CC:DOM:FI&P

Assistant Chief Counsel  
(Field Services)  
CC:DOM:FS